DOCUMENT RESUME

ED 426 484 EA 029 582

AUTHOR	Watkiss, Jeffrey D.
TITLE	Deregulation of the Electric Industry and Its Potential Benefits for School Districts.
INSTITUTION	National School Boards Association, Alexandria, VA. Council of School Attorneys.
PUB DATE	1997-07-00
NOTE	7p.
AVAILABLE FROM	NSBA Council of School Attorneys, 1680 Duke Street, Alexandria, VA 22314 (by subscription: $75 for 6 bimonthly issues).
PUB TYPE	Journal Articles (080)
JOURNAL CIT	Inquiry & Analysis; p1-5 Jul 1997
EDRS PRICE	EDRS Price MF01 Plus Postage. PC Not Available from EDRS.
DESCRIPTORS	Consortia; Cooperative Planning; Cooperative Programs; *Electricity; Elementary Secondary Education; Energy; *Shared Resources and Services; *Utilities
IDENTIFIERS	*Deregulation; Monopoly

ABSTRACT

The electric utility industry is the last bastion of regulated monopolies in the United States. An overview of recent competition in the electric-power industry at both the federal and state levels and how this may affect school districts is offered in this article. The text identifies and evaluates how school districts can obtain cheaper power contracts by taking advantage of competition in the electric industry. School districts in New York and California are already pooling together and positioning themselves to benefit from lower electric rates. Some of the concerns that school districts may have about competition, which differ from the needs of large industrial users of electricity, are examined. The progress of deregulation in the states, the likelihood of federal legislation requiring states to open their electric markets, what competition means for schools, and concerns when entering into a management agreement with a power marketer are all discussed. Updates on state electric deregulation legislation in California, New Hampshire, Rhode Island, Pennsylvania, Montana, Oklahoma, and Maine are presented. Within the next 5 to 7 years, customer choice should be available in almost every state. School districts will need to forge alliances with other districts, prepare RFPs, and look into making arrangements with power marketing companies. (RJM)

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JULY 1997

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INTRODUCTION

In the 1970s, the airline services industry was largely deregulated. In the 1980s, the AT&T monopoly was broken up to pave the way for competition in the long distance telephone industry. Now Congress and state lawmakers and regulators have shifted their focus to electricity. The electric utility industry is the last bastion of regulated monopoly in the United States, and each year brings the prospect of competition one step closer. During the past four years, the electric utility industry in the United States has undergone the most profound changes since 1935, when Congress enacted the Federal Power Act (FPA)[1] and the Public Utility Holding Company Act (PUHCA).[2] Competitive access and market entry at the wholesale level has already occurred since passage of the Energy Policy Act of 1992 (EPAct)[3] and the Federal Energy Regulatory Commission's (FERC) issuance of its ground breaking Order No. 888[4] in 1996. The next step on which states are now focusing is retail competition.

This article will first provide an overview of recent competitive developments in the electric power industry at both the federal and state levels. Next, it will identify and evaluate how school districts can seek to take advantage of competition in the electric industry to obtain cheaper power contracts and save money. In fact, several schools districts are already pooling together and positioning themselves to benefit from lower electric rates. Examples of these efforts from New York and California are described. Also addressed are some of the concerns that school districts may have about competition, which differ to some extent from the needs of large industrial users of electricity. Specifically, the discussion will focus on the need to ensure that the electric supply to schools remains reliable and the ability of school districts to work with power marketers to arrange power contracts that suit the particular needs of schools. Finally, the article briefly discusses legislation recently enacted in several states that are leading the country in bringing choice to their electric consumers.

BACKGROUND

Given the tremendous expense necessary to build electric power plants and transmission lines, electric utilities used to be considered "natural monopolies" in each of the services that they provide. Federal and state governments believed only one company could provide service in a given area and deliver electricity in an efficient and cost-effective manner. States granted utilities exclusive franchise territories and, in exchange, utilities agreed to submit to regulation. Regulation ensures that utilities provide adequate, reliable service to all customers within their service territory. Regulators also attempt to hold down electric prices to allow utilities to recover only their cost-of-service plus a reasonable return on investment, without exacting monopoly rents. For many years, electricity was a declining cost industry under regulation. In recent years, however, electricity prices began to rise in many areas, particularly in the Northeast and in California as a number of utilities began building costly nuclear power plants and generally incurring higher costs to generate power.[5]

In the 1980s and 1990s, the electric industry changed dramatically. With passage of the Public Utility Regulatory Policies Act of 1978 (PURPA),[6] Congress required utilities to buy power from non-utility generating firms — qualifying facilities (QFs) and small renewable energy generators. Using predominantly efficient natural gas generators, these independent

1. 16 U.S.C. §§ 791a - 825u (1996).
2. 15 U.S.C. §§ 79 to 79z-6 (1996).
3. Energy Policy Act of 1992, Pub. L. No. 102-486, 106 Stat. 2776 (1992).
4. *Promoting Wholesale Competition Through Open Access Non-Discriminatory Transmission Services by Public Utilities; Recovery of Stranded Costs by Public Utilities and Transmitting Utilities*, ¶ 1991-96 Regs. Preambles] & ¶31,036, 61 Fed. Reg. 21,540 (1996), order on rehearing, 62 Fed. Reg. 12,274 (1997) (hereinafter "Order No. 888").
5. Timothy J. Brennan, et al., *A Shock to the System: Restructuring America's Electricity Industry*, RESOURCES FOR THE FUTURE 4-5 (Washington, D.C., 1996).
6. 6 U.S.C. §§ 2601 - 2645 (1996).

EA 029582

INQUIRY & ANALYSIS is a bi-monthly publication of the NSBA Council of School Attorneys, 1680 Duke Street, Alexandria, Virginia 22314, (703) 838-6722. Naomi E. Gittins, Staff Attorney and Editor; Gary R. Thune, Council Chairman; William B. Ingram, NSBA President; Anne L. Bryant, NSBA Executive Director; August W. Steinhilber, General Counsel; Gwendolyn H. Gregory, Deputy General Counsel; Susan R. Butler, Director, Administration and Lindsay Andrews, Legal Services Manager. *I&A* is a membership service of the Council or can be purchased by subscription for $75/6 issues. Copyright © 1997 by the National School Boards Association. All Rights Reserved.

generators produced power more efficiently than the public utilities and could sell power at more competitive rates.[7] In 1992, Congress passed the EPAct, further increasing competition in the generation of power by permitting independent generation companies to enter the wholesale markets where they could sell power to utilities at market-based rates, without triggering regulation under PUHCA.[8]

Most importantly, the EPAct granted authority to the FERC to require all utilities to provide access to their transmission lines, upon request, to competing power sellers seeking to transmit power to wholesale purchasers.[9] Because most utilities' transmission lines are interconnected, it is now possible to move power from one region of the country to another across the transmission lines of several utilities. Building upon EPAct, last year the FERC issued its landmark Order No. 888, which requires the nation's investor-owned electric utilities to let competitors transmit electricity through their transmission lines as long as the competitors pay for this service. Utilities must offer competitors the same rates and conditions for using transmission facilities as the utilities apply to themselves.[10]

RETAIL ACCESS: PROGRESS IN THE STATES AND THE LIKELIHOOD OF FEDERAL LEGISLATION

The federal government only has direct authority over wholesales of electricity — that is, bulk sales of electricity for resale. Congress has left to state regulators the task of regulation of retail sales to end use customers.[11] Within the next year, however, it is distinctly possible that Congress will enact legislation that requires all states to open their electric markets to competition by a date certain.[12] If enacted, this legislation is likely to provide for uniformity in the speed of implementation and quality of competition throughout the country, and to address system reliability and environmental issues as well.[13] Through June 1997, six bills dealing with varying aspects of electric deregulation have been introduced in this session of Congress, with several containing a date certain for introduction of retail competition. The most aggressive of these is H.R. 1230, introduced by Rep. Tom DeLay (R-TX), which would require complete deregulation of retail electric sales in all states by January 1, 1999. Other bills introduced by Rep. Dan Schaefer (R-CO) (H.R. 655) and Sen. Dale Bumpers (D-AK) (S. 237) would give all consumers the right to purchase electricity competitively no later than December 15, 2000, and December 15, 2003, respectively.

Concurrent with these federal legislative initiatives, many individual states have begun the process of implementing retail competition. Forty-six states are now in various stages of restructuring electric industry operations at the retail level. Six states, California, Oklahoma, Montana, Pennsylvania, Rhode Island, and most recently, Maine, have enacted legislation that would introduce retail power competition beginning in 1998. Regulatory agencies in other states, such as Illinois, Michigan and New Hampshire, have developed retail pilot programs to study the effect of retail wheeling for a limited period of time before full scale implementation of state-wide restructuring plans. These programs, typically confining participation to certain types of customers in specific areas of a state, allow individual industrial and retail consumers of electric power to choose their electric provider in the same way that we can now choose our long-distance telephone company.[14]

The future ability of school districts to purchase power competitively is inextricably bound with the decisions of Congress, state legislatures and state regulatory agencies. The deregulation plans implemented by these states are discussed in further detail below.

WHAT COMPETITION MEANS FOR SCHOOLS

As the opportunity for competition nears, many large consumers are positioning themselves to obtain the benefits of cheaper power. Some industrial consumers are already signing contracts with "power marketers," to guarantee provision of power at cheaper rates once retail competition begins. Power marketers are companies authorized by FERC to wholesale power at market-based rates. Many of them are interested in teaming up with school districts to assist them with taking advantage of competition.

Much of the push toward electric deregulation is coming from large industrial customers. Electricity is a major cost of production for these companies. Energy-intensive industries stand to reap significant savings from deregulation by negotiating discounted rates with power marketers in the newly competitive marketplace. By paying substantially less for their electric power needs, companies can reduce costs and increase profits. For some companies in the chemical industry, for example, electricity can be 50 to 80 percent of the cost of production. The savings realized by the industrial sector from purchasing electricity at competitive rates will be passed along to the consumer.

Like large industrial consumers of energy, schools and school districts can also position themselves to take advantage of competitive supply opportunities in the electric power industry. Schools, however, have unique concerns that require special attention. With competitive procurement in the electric power industry, consumers accustomed to stable prices will have to adapt to the volatility associated with market-driven prices. Price volatility is of particular concern to entities with fixed energy budgets, such as small companies and particularly school districts, many of whose budgets are allocated ex ante in a legislative process. A number of lessons can be learned from

7 Peter Fox Penner, *Electric Utility Restructuring: A Guide to the Competitive Era*, Public Utility Reports 14-15 (Vienna, Va., 1996).

8 See Richard Pierce, *The State of the Transition to Competitive Markets in Natural Gas and Electricity*, 15 Energy L. J. 232 (1994).

9 Jeffrey D. Watkiss and Douglas W. Smith, *The Energy Policy Act of 1992: A Blueprint for Competition in the Wholesale Power Market*, 20 Ecology L.Q. 327, 356 (1993).

10 Order No. 888, [1996-96 Regs. Preambles] FERC Stats. & Regs. ¶ 31,036 at 31,672, 31,730.

11 See Isaac D. Benken, *Who Makes the Rules? Federal and State Jurisdiction over Electric Transmission Access*, 19 Energy L. J. 45 (1998); Sale Chadwick, *Ground Rules: Federal Preemption of States' Authority Over Retail Wheeling of Electricity*, 28 Conn. L. Rev. 291 (1996).

12 Jonathan Bowman, *Drive to Open Power Industry to Competition Gains Steam*, 74 Gas. Q. 2901 (Oct.-Dec. 1996).

13 Watts Kanner, *Federal Restructuring Legislation: A Recipe for Successful Action*, 10 Energy L. J. 29 (Mar. 1997).

14 See Kenneth W. Costello, *The Next Question Round for State Regulators and Electric Utilities: The Unbundling of Retail Services*, 9 Energy L. J. 36 (Nov. 1996).

school coalitions in New York and California that are already making efforts to obtain cheaper electric power.

New York

In New York, the Eastern Suffolk County Board of Cooperative Educational Services (BOCES) provides instructional and management services to 71 school districts in Suffolk County, with a student population of about 225,000. In 1994, BOCES formed a consortium, the Educational Electric Buying Group, to purchase low-cost electric power for school districts to replace the power being provided by the Long Island Lighting Company (LILCO). On May 12, 1994, the Buying Group filed with the New York State Public Service Commission (NYPSC) a petition seeking approval to purchase electricity on the open market on behalf of the county's school districts pursuant to a three-year pilot program.[17] The power supplied would be interruptible power wheeled through the LILCO transmission system.

The Suffolk County school districts spend about $30 million per year on electricity and BOCES estimates that the school districts could save 30 percent of that total by purchasing electricity competitively. This savings of $9 million plus could be used to stabilize the property tax rate, purchase new textbooks and equip schools with computers and other advanced technology. As Suffolk County schools strive to provide better services in the face of increasing economic limitations, they view savings in electricity as a budgetary blessing. Electric power is the only commodity that most schools do not now procure by competitive bidding.

Moreover, the Suffolk County schools complain that they have traditionally subsidized all other ratepayers through high summer demand charges in spite of the fact that they do not contribute to a utility's peak demand. The demand charge for a Long Island school is almost seven cents per KWH, which is substantially higher than the demand charge to the average commercial customer. The schools also pay energy charges and other customer charges resulting in some cases in a cost of more than 17 cents per KWH. Through competitive bidding, the schools would see savings of possibly better than 500 percent over their current charges.

During the pilot program, the Long Island Buying Group will solicit bids from power suppliers (utilities, marketers and independent power producers) on a monthly basis in compliance with New York's municipal and education laws. The Buying Group plans to purchase power on an interruptible basis when LILCO has intertie capacity available, or when indigenous generators can supply power without compromising system reliability. System reliability will not be compromised because LILCO will schedule all transactions through the New York Power Pool. Thus, LILCO will act similar to an Independent System Operator (ISO) because it will perform scheduling functions but will not be privy to price information at the time of a transaction. Individual members of the Buying Group will continue to pay demand charges to LILCO under their existing tariffs regardless of the source of any power consumed. When power is substituted because of limitations on intertie capacity, payment of demand charges associated with the bundled sales rate will function as the wheeling rate.

Although the petition by the Suffolk County Buying Group has been pending for nearly three years, the state Public Service Commission has failed to act on it because the utility, LILCO, has protested the move. Because retail wheeling does not yet exist in New York, the schools' proposal would have to be approved as a special pilot program that is an exception to the current franchise electric system in the state. Unfortunately, until the Public Service Commission or the state legislature moves forward with retail deregulation plans, it appears this proposal by the Suffolk County schools will not be implemented any time soon.

California

The School Project for Utility Rate Reduction (SPURR) and the Regional Energy Management Coalition (REMAC) are two Joint Power Authorities (JPA) of California public school districts. They represent a combined membership of approximately 350 school districts, (about one-third of school districts in California). Last year, SPURR and REMAC issued a Request for Proposals seeking an energy service provider (ESP) to provide the schools with low-cost reliable power. Included among the issues to address in its RFP were:

- a description of pricing mechanisms (*i.e.*, fixed price, discount to market clearing price or an indexed California border price) and means for ensuring reliable supply quantities;
- a description of the mechanism employed if time-of-use pricing is contemplated;
- physical arrangements to provide for hourly or more frequent dispatch in order to reduce power generation costs and avoid transmission line congestion;
- methods to insure that the ESP or its Schedule Coordinator can monitor and match power inputs with the actual requirements of SPURR/REMAC;
- options the ESP would employ to restore balance if there is a mismatch between power receipts and usage needs;
- description of the billing process the ESP intends to use;
- an audit consisting of a comparison of purchase prices against another index over-time basis to ensure that SPURR/REMAC is obtaining the least-cost reliable supply of electricity; and
- the fee structure by which the ESP would be compensated.

ENTERING INTO A MANAGEMENT AGREEMENT WITH A POWER MARKETER

In order to take advantage of the coming restructured electric market and purchase power competitively, a purchase alliance of school districts would benefit by retaining the expertise and services of a power marketer for purposes of directing, managing and administering the schools' purchase of electric power and delivery to alliance members. Given the present complexities of purchasing electric power, and the likelihood of further changes to the industry, entering into a management agreement with a power marketer will enable school districts to evaluate the broadest range of opportunities and select the best deal for their needs.

A power marketer can assist school districts with the following:

- oversee and coordinate all bidding procedures for the

17. Petition of the Educational Electric Buying Group for authority to lower the operating costs of public school districts on Long Island by purchasing electric power and having it replace the electric power which would otherwise be generated or purchased by the Long Island Lighting Co., N.Y.P.S.C. Case No. 94-E-0365, filed May 12, 1994.

purchase of electric power in accordance with the laws of the state;

- identify suppliers of electric power and coordinate all purchase arrangements with suppliers, including determining the amount of power to be purchased, the purchase price, and the terms of delivery. For example, the power marketer could request bids from at least ten wholesale electric power vendors each month and select the most cost-effective vendors each month;
- coordinate delivery of electricity to the school's transmitting/distributing utility;
- act as a liaison between the schools, the transmitting/distributing utility and other electric power suppliers for submitting reports and data;
- prepare and maintain the books and records of the school coalition with respect to the purchase of electric power and delivery to school members;
- prepare and manage invoicing of school members for electric power delivered and oversee the collection of revenues from members on behalf of the school purchasing alliance; and
- provide the school purchasing alliance with a list of electric power suppliers to enable the coalition to pay each supplier directly.

In exchange for performing these services for the schools, the power marketer might be compensated through a monthly fee of, for example, ten percent of the savings realized by the schools after purchasing power competitively each month. The school districts in New York have entered into such an agreement, pending approval from the NYPSC.

PROGRESS OF STATE ELECTRIC DEREGULATION LEGISLATION

California

School districts in California will most likely be the first to experience competitive procurement of electricity. As one of the first states to pass legislation mandating customer choice, California has led the way in the area of electric restructuring. California Governor Pete Wilson signed Assembly Bill 1890 into law on September 23, 1996. It provides for customer choice beginning on January 1, 1998, and includes a guaranteed ten percent rate reduction for residential and small commercial customers beginning in 1998, and a cumulative rate reduction of at least 20 percent beginning April 1, 2002. The legislation also guarantees payment of about $28 billion to the state's three major investor-owned utilities — Pacific Gas & Electric Co. (PG&E), Southern California Edison Co. (Edison) and San Diego Gas & Electric Co. (SDG&E) — for investments and liabilities that could not otherwise be recovered in a competitive environment (*i.e.*, "stranded costs"). The legislation establishes an Independent System Operator (ISO) to coordinate operations of a state-wide transmission grid and a Power Exchange (PX) to allow for the competitive buying and selling of electricity on a day-ahead and hour-ahead basis.

New Hampshire

On May 22, 1996, New Hampshire Governor Steve Merrill signed legislation (H.B. 1392) requiring retail choice in the state to be available by January 1, 1998, but allowing for a six month delay, if necessary. The legislation ordered the state Public Utilities Commission (PUC) to issue a detailed final restructuring plan, which it did on February 28, 1997. Meanwhile the state has had an experimental retail wheeling pilot program in effect since May 28, 1996. The program, which is scheduled to last for two years, includes all classes of customers. Half of all customers participating in the pilot are chosen randomly by utilities from a pool of volunteers. The other half of the residential and business customers are located in a "geographic area of choice" (GAC) established by each utility. The pilot program already appears to have saved money for both industrial and residential participants. A preliminary survey conducted by the Electricity Consumers Resource Council (ELCON) shows that industrial customers have saved an average of 20 to 30 percent on electricity costs, while non-industrial customers have saved an average of 15 to 20 percent on their electric bills.

Rhode Island

Rhode Island's push for electric utility restructuring came to fruition on August 7, 1996, with passage of the Utility Restructuring Act of 1996 (H.B. No. 96-HS124), which implements three restructuring phases, culminating in full retail customer choice by July 1, 1998. By July 1, 1997, the law extends retail access to new customers with an anticipated average annual demand of 200 kW or greater, existing manufacturing customers with an average annual demand of 1,500 kW or greater, and state agencies. By January 1, 1998, manufacturing customers with an average demand of 200 kW or greater and municipal accounts will be added to the mix. In the final phase, Rhode Island will implement open access for all customers, either within six months of when 40 percent of New England has retail access or by July 1, 1998, whichever comes first. At this point, school districts should be eligible to take advantage of retail access as well. Rhode Island legislators anticipate that the new legislation will result in a 14-18 percent decrease in customer rates and stimulate economic growth previously stifled by high power rates.

Pennsylvania

On December 3, 1996, Pennsylvania became the third state to enact legislation deregulating the electric industry and phasing in retail competition. Signed into law by Governor Tom Ridge just one week after it was passed by the legislature, the new law (Amendment A-7697 to House Bill 1509) will phase in customer choice, offered on a first come-first served basis, to one-third of each of the Commonwealth's customer classes (residential, commercial, and industrial), over three years.

The first phase-in begins in January 1999 and culminates in full customer choice by 2001. The Pennsylvania Public Utilities Commission (PaPUC) will have the authority to delay this proposed schedule if such a delay becomes necessary and is authorized to prevent competitive disadvantages among customers within a customer class by making adjustments to the phase in plan. The law also includes a plan to create retail pilot programs that began earlier this year. The pilot programs will last at least one year and cover five percent of peak load for each customer class for each utility. Thus, Pennsylvania schools located within the retail pilot areas can immediately begin to

source competitively a portion of their power needs. The Commonwealth's utilities are required to separate or "unbundle" their generation assets from transmission and distribution functions; although generation of electricity will be open to competition, transmission and distribution services will remain regulated monopolies.

Montana

Montana's "Electric Industry Restructuring and Customer Choice Act" (S.B. 390), passed by the legislature on April 15, 1997, provides that all customers with individual loads greater than 1,000 kilowatts must be given the opportunity to choose their own electricity supplier on or before July 1, 1998. This should include most, if not all school districts, particularly if aggregated into a purchasing alliance. Before July 1, 2002, all other public utility customers must be given that same opportunity. The Act allows the Montana Public Service Commission (MPSC) to determine that additional time is necessary for complete customer choice in the electric industry, but full customer choice must be implemented no later than July 1, 2004 in any event. All public utilities are also required to submit a transition plan to the MPSC no later than one year before the date by which any customers of the public utility are entitled to choose an electricity supplier.

Beginning July 1, 1998, the Act directs all utilities to conduct pilot programs using a representative sample of their residential and small commercial customers. School districts should be eligible to participate. Utilities must also submit a report describing and analyzing the results of the pilot programs to the commission and a "transition advisory committee."

Oklahoma

While not as extensive as laws enacted in other states, Oklahoma's electric restructuring law, approved by the state legislature on April 25, 1997, requires full customer choice for the Sooner State by July, 2002 (S.B. 500). The bill delegates most of the details of restructuring to the Oklahoma Corporation Commission (OCC) and a House-Senate legislative group, the Joint Electric Utility Task Force. The law sets a series of deadlines for the OCC to begin studies on various issues related to power industry restructuring and a series of deadlines by which the OCC must submit reports to the Task Force. The OCC is prohibited from promulgating any rules or issuing any orders relating to restructuring without prior express permission from the legislature. Given the large gaps that the legislature has left for regulators to fill, exactly how much customers such as school districts will save on electricity in a competitive environment remains uncertain.

Under the new law, electric bills for all customer classes will be unbundled and itemized to reveal the various component cost of providing electric services. Recovery of "an appropriate amount of prudently incurred, unmitigable and verifiable stranded costs and investments" will be permitted and each utility must file a recovery plan establishing its stranded costs and a limited recovery period designed to recover those costs. Transition costs shall not cause the total price for electric power for any consumer "to exceed the cost per kilowatt-hour paid on the effective date of this act during the transition period." The bill also provides that any transition charge will be allocated over a period of not less than three, but not more then seven, years.

Maine

On May 29, 1997, Maine became the most recent state to approve restructuring legislation. Retail customer choice will be available in March 2000 and the legislation (Bill No. 1784) will bring competition to distribution services such as billing and metering by 2002. Investor owned utilities (IOUs) must divest themselves of their generation assets, but are guaranteed recovery of "legitimate, verifiable and unmitigable" stranded costs. IOUs, however, are prohibited from selling power to more than one-third of their native load customers. In addition, those sales may be made only through a marketing affiliate. While Maine IOUs may bid to provide default "standard offer" service to those customers who do not choose a company to supply their electricity, no single utility may service more than 20 percent of those customers.

CONCLUSION

Just as large industrial consumers of electricity are positioning themselves to take advantage of retail competition in the electric industry, school districts can also benefit from reduced electric costs. Within the next five to seven years, customer choice should be available in almost every state. For school districts in those states that are already moving quickly to implement deregulation, now is the time for school districts to begin forging alliances with other districts, preparing RFPs, and looking into making arrangements with power marketing companies. Even in those states that are taking a slower approach, school officials should be closely monitoring developments in the now fast-paced electric utility industry.